


EFTA SURVEILLANCE AUTHORITY

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EFTA SURVEILLANCE AUTHORITY DECISION

OF 17 APRIL 1996

ON CLOSURE OF A COMPLAINT ON AID TO A HOTEL PROJECT IN SULDAL (NORWAY)

THE EFTA SURVEILLANCE AUTHORITY,

Having regard to the Agreement on the European Economic Area¹, in particular to Articles 61 to 63, Article 109 and Protocols 26 and 27 thereof

Having regard to the Agreement between the EFTA States on the establishment of a Surveillance Authority and a Court of Justice², in particular Article 1 of Protocol 3 thereof,

WHEREAS:

I. FACTS

1. The complaint

By letter dated 9 June 1995, received by the EFTA Surveillance Authority on 14 June 1995 (ref. 95-3540 A), a complaint was lodged with the Authority on public financing of a new hotel to be located in the Municipality of Suldal. By letter of 25 September 1995 (ref. 95-5573 D) the complainant was informed that his complaint had been registered and that it was being examined by the Authority's Competition and State Aid Directorate. The complainant supplied further information by letter of 21 February 1996 (ref. 96-1043 A)

By letter of 25 September 1995 (ref. 95-5588 D) the Competition and State Aid Directorate of the Authority requested detailed information from the Norwegian authorities on the financing arrangement established for the hotel project and on the institutions involved in that arrangement. The requested information was submitted by the Norwegian authorities by letter of 8 November 1995 received on 9 November 1995 (ref. 95-6453 A), and later supplemented by information attached to faxes of 2

¹Hereinafter referred to as the EEA Agreement

²Hereinafter referred to as the Surveillance and Court Agreement

January 1996 (ref. 96-11 A), 26 February 1996 (ref. 96-1114 A) and 14 March 1996 (ref. 96-1411 A) from the Ministry of Industry and Energy, and fax of 12 March 1996 (96-1412 A) from Suldal Utviklingsselskap AS.

The complainant considers that the provision of public share capital by the Municipality of Suldal amounting to NOK 10.4 million, which alone equals about 40 per cent of the total investment, is in reality subsidies.

Since tourism is a service sector comprised by the EEA Agreement and since, according to the complainant, the hotel project to a large extent is marketed outside of Norway, he considers that the public equity participation conflicts with the EEA rules and regulations concerning maximum aid intensity.

Finally, the complainant questions whether the injection of public equity capital should not have been notified to the Authority. On the above grounds he demands that the award of public equity capital be stopped.

2. The hotel project

The hotel under consideration is located in Suldal, a relatively small municipality in terms of population (4200 inhabitants). Suldal is covered by target zone C according to the Norwegian map of assisted areas eligible for regional investment aid.

The hotel project was initiated by the municipality authorities. In preparing the project, a consultant (Reiselivsutvikling A/S Bergen³) was requested to evaluate such a hotel project with respect to market prospects, the service concept, investments, financing, operating costs and operating surplus. Reiselivsutvikling A/S' report states that Suldal is relatively well placed with respect to tourism. The municipality has only 2 hotels each with a capacity of 50 beds. The new hotel will have a capacity of approximately 100 beds. Reiselivsutvikling A/S has estimated the turnover for such a hotel to approximately NOK 8 million per year in the first years of operation. Total wages and social costs have been estimated to approximately NOK 3 million per year.

The municipality authorities' decision to initiate the hotel project was taken in 1991⁴. With reference to that decision, the Municipality of Suldal decided on 23 October 1993⁵ to provide NOK 6 million in extra-ordinary financing to enable Suldal Utviklingsselskap A/S (SUS A/S)⁶ to follow up its decision of 21 September 1993 to award NOK 10.4 million in public equity capital to Ryfylke Hotell Eigedom AS (RHE)⁷.

³Vurdering av hotellprosjekt - Sand, Suldal kommune. Reiselivsutvikling A/S Bergen Oktober 1991

⁴Kommunestyresak 161/91 Nytt hotellprosjekt på Sand (långivingsak)

⁵Kommunestyresak 105/93, Suldal utviklingsselskap A/S, 4230 Sand. Søknad om ekstraordinær overføring av midlar til egenkapital i hotellprosjekt på Sand.

⁶Suldal utviklingsselskap A/S carries out local business support activities on behalf of its owner, the municipality of Suldal, from which it receives financial support on a regular basis. SUS' budget for 1995 was NOK 3.65 million.

⁷Protocol, Suldal Utviklingsselskap AS 21.9 1993.

RHE was established on 20 January 1994 for the purpose of building, owning and renting out the hotel property under consideration. RHE is foreseen to have a total share capital of NOK 12.7 million. NOK 2.3 million (18%) of the share capital is financed from private sources⁸, while NOK 10.4 million (82%) has been provided by the municipality through SUS A/S. RHE will rent the hotel fully equipped with land and buildings to Ryfylke Turisthotell A/S (RTH) which will run the hotel. RTH is a private company established for this purpose.

SR Bank⁹ awarded on 6 December 1994 a first priority loan of NOK 5.5 million to the hotel project. The interest rate was 8.25 % p.a. The loan was conditional on the establishment of an equity capital for RHE A/S of NOK 12.7 million and on the loan from Ulla-Førre Næringsfond referred to below would be used first.

The county authorities granted on 20 December 1994 through Rogaland Fylkeskommunes Næringsfond¹⁰ a loan with second priority to the hotel project. The loan is limited to NOK 3.750 million and carries a flexible interest rate, initially set to 7 % p.a. (plus handling fees). Exemption from repayments on principal may be granted during the first two years of operation.

Ulla-Førre Næringsfond¹¹, committed itself in 1991¹² to provide loan financing for 15 % of the project costs limited to NOK 3.9 million. The decision to pay out the loan was taken on 5 December 1995¹³. The loan carries an interest rate of 7 % p.a. Exemption from repayments on principal may be granted during the first three years of operation. The security of the loan has third priority, i.e. after the two loans referred to above.

The table below provides an overview of the financing plan for the hotel project.

Loan financing	Source	NOK 13.15 million
whereof		
Private:	SR Bank (first priority)	NOK 5.50 million
Public:	Rogaland Fylkeskommune	NOK 3.750 million
	Ulla-Førre Næringsfond	NOK 3.90 million
Equity capital		NOK 12.70 million
whereof		
Private	Private investors	NOK 2.3 million
Public	Suldal Utviklingsselskap A/S	NOK 10.4 million
Total financing		NOK 25.85 million

⁸Local companies have according to Protocol, Suldal Utviklingsselskap AS 21.9 1993, committed themselves to provide equity capital.

⁹SR Bank is a private savings bank.

¹⁰The scheme (Aid No 93-395) has been reported to the Authority.

¹¹Ulla-Førre Næringsfond was established in 1974. The financial basis for the fund is an initial grant by the State through Statkraft and proceeds from concession fees paid by Statkraft in accordance with the concession provisions for the Ulla-Førre hydro-electric power plant.

¹²Kommunestyresak 161/91 Nytt hotellprosjekt på Sand (långivingssak)

¹³Protocol Suldal kommune, decision 171/95 of 5 December 1995.

II. APPRECIATION

The complainant has requested the Authority to examine whether the public financing of the hotel project under consideration constitutes a breach of Article 61(1) EEA and whether the obligation to notify plans to grant aid was not respected. The Authority is therefore obliged to examine whether State aid in the meaning of Article 61(1) was involved.

Equity capital

It emerges clearly from the information provided by the Norwegian authorities that the decision to award equity capital in favour of the hotel project was taken by the Municipality of Suldal on 23 October 1993, i.e. before the entry into force of the EEA Agreement. Any aid related to the provision of the public equity capital is therefore considered to have been awarded on that date.

Neither the EEA Agreement nor the Surveillance and Court Agreement confer any competence to the Authority to decide on State aid which is deemed to have been granted before the entry into force of the EEA Agreement¹⁴.

The compatibility of any aid related to the Municipality of Suldal's provision of equity capital in favour of the hotel project under consideration may consequently not be decided upon by the EFTA Surveillance Authority. The Municipality of Suldal was, accordingly, not subject to any notification obligations vis-à-vis the Authority when the public equity capital was provided.

Loan financing

There can be no doubt that the loans awarded by respectively Rogaland Fylkeskommunes Næringsfond and Ulla-Førre Næringsfond were provided from public funds. Furthermore, the hotel will be in competition with undertakings in other States participating in the EEA.

The Authority has observed that both loans have been awarded on favourable terms, i.e. at reduced interest rates compared not only to the reference rate of interest which the Authority applies, in accordance with paragraph 27(3)(f) of the Procedural and Substantive Rules in the Field of State Aid adopted by the EFTA Surveillance Authority on 19 January 1994 (State Aid Guidelines) to calculate the aid element of loans, but also in comparison to the private loan from SR Bank¹⁵. It may therefore be concluded that the loans were not granted on market conditions and that the favourable terms constitute State aid.

¹⁴Hereinafter referred to as "pre-EEA" aid

¹⁵The reference rates of interest for Norway in 1994 and 1995 were respectively 7.5 % and 8.19 % p.a., while the loan from Rogaland Fylkeskommunes næringsfond was awarded with an interest rate of 7 % in December 1994 and the loan from Ulla-Førre Næringsfond was also awarded with an interest rate of 7 % in December 1995. The loan from SR Bank was awarded with an interest rate of 8.25 % p.a. in December 1994.

Based on the method indicated in paragraph 27.(3)(e) of the State Aid Guidelines, the Authority has estimated¹⁶ the aid element of the loan awarded by Ulla-Førre Næringsfond to NOK 0.385 million. The corresponding figure for the loan awarded by Rogaland Fylkeskommunes Næringsfond is NOK 0.154 million. Taken together, the aid elements inherent to these two public loans constitute 2.1 % of the investment costs.

Compatibility with the EEA Agreement

Suldal is covered by target zone C, which the Authority has found eligible for regional investment aid with reference to Article 61(3)(c) EEA in its decision of 16 November 1994 on the Norwegian map of assisted areas¹⁷. The cumulative aid ceiling in target zone C is 15 % NGE (net grant equivalent)¹⁸ plus a top-up for small- and medium-sized enterprises (SME) of 10 % (gross).

The Ministry of Local Government and Labour has by Circular letter H-11/95 of March 1995, established provisions which foresee that the aid ceilings related to the map of assisted areas in Norway apply to investment aid awards under existing aid schemes and that existing aid schemes which are not explicitly linked to the map of assisted areas, such as the Ulla-Førre Næringsfond and Rogaland Fylkeskommunes Næringsfond, must respect the cumulative ceilings for regional investment aid.

In this context the Authority has noted that the ceiling would not have been exceeded even if one were to take into account the "pre-EEA" aid element related to the provision of public equity capital by the Municipality of Suldal. The "pre-EEA" aid element has been estimated to NOK 4.3 million by applying the discounted cash flow method¹⁹. Taken together, the hotel project may be considered to have received a total amount of aid from public sources amounting to NOK 4.8 million, which is equivalent to 18.8 % (gross) of the project costs. The economic prospects of the hotel project and the financial relations of RHE show that RHE, as real estate company, qualifies as an SME as defined in section 10.2 of the State Aid Guidelines.

It must therefore be concluded that the aid provided in favour of the hotel project by Ulla-Førre Næringsfond and Rogaland Fylkeskommunes Næringsfond was awarded in compliance with the rules on cumulation of aid from different sources. The aid is compatible with the functioning of the EEA Agreement as it has been awarded in conformity with provisions for regional investment aid which have been approved by the Authority.

¹⁶See Annex to this decision

¹⁷Dec. No 157/94/COL of 16 November on the map of assisted areas (Norway)

¹⁸Approximately 20.8 % gross grant equivalent

¹⁹See Annex to this decision

Existing aid

The State Aid Guidelines distinguish between existing aid, as defined in the following paragraph, and plans to grant or alter aid which the EFTA States, in accordance with Article 1(3) of Protocol 3 of the Surveillance Court Agreement, are obliged to notify to the Authority before they are put into effect. Payments of existing aid are not covered by such notification obligations.

The notion of existing aid is defined as "*aid schemes in operation at the entry into force of the EEA and individual awards of aid which have been decided upon before and foresee payments after the entry into force of the EEA Agreement*" and "*authorized aid, i.e. aid schemes or ongoing provisions of aid that have been authorized or are deemed to have been authorized by the EFTA Surveillance Authority*"²⁰.

It is clear that Ulla-Førre Næringsfond and Rogaland Fylkeskommunes Næringsfond are existing aid schemes, both established in the 1970s, which were in operation at the entry into force of the EEA Agreement. The decisions to pay out loans under these schemes in favour of the hotel project were taken on respectively 5 December 1995 and 20 December 1994, i.e. after the entry into force of the EEA Agreement.

As the schemes were established before 1 January 1994, the aid elements related to the above financial measures are covered by the notion of existing aid. Such aid is lawful on procedural grounds, unless it has been misused in the meaning of Article 1(2) of Protocol 3 to the Surveillance and Court Agreement²¹.

The Ulla-Førre Næringsfond and Rogaland Fylkeskommunes Næringsfond were therefore not obliged to notify the Authority of their payments of loans in favour of the hotel project.

The Authority has found nothing to indicate that the existing aid awarded in favour the hotel project under consideration has been misused in the meaning of Article 1(2) of Protocol 3 to the Surveillance and Court Agreement.

Conclusions

The EFTA Surveillance Authority's examination of the aid granted to the hotel project under consideration has led to the following conclusions:

- The public equity capital provided by the Municipality of Suldal was awarded before the entry into force of the EEA Agreement. The Authority is therefore not competent to decide on the compatibility of any aid element related to the municipality's provision of equity capital. The Norwegian authorities were not subject to any notification obligations vis-à-vis the Authority when the public equity capital was provided.

²⁰See paragraph 7.2 of State Aid Guidelines

²¹See paragraph 6.1. of the State Aid Guidelines

- Certain proportions of the public loan financing provided in favour of the hotel project constitute State aid.
- The payments of the public loans in favour of the hotel project under consideration were lawful on procedural grounds as the aid elements are covered by the notion of existing aid. The Norwegian authorities were therefore not under the obligation to notify the payments of the aid to the Authority in advance.
- The Authority's examination has shown that the aid related to the loan financing under consideration was also in substance compatible with the functioning of the EEA Agreement as the aid was awarded in conformity with provisions for regional investment aid which have been approved by the Authority. Furthermore, the rules on cumulation of aid from different sources are respected.


A decision may therefore be taken to conclude the examination of the complaint without proposing any further action.

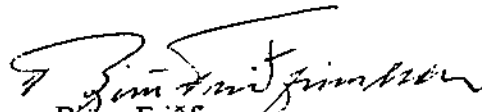
HAS ADOPTED THIS DECISION:

1. The EFTA Surveillance Authority has decided to close its investigation of the complaint lodged with the Authority on 14 June 1995 (ref. no. 95-3540 A) concerning aid to a hotel project in Suldal without proposing any further action.
2. The complainant and the Norwegian Government are informed by letters stating the relevant findings of the EFTA Surveillance Authority's examination.
3. The European Commission is informed in accordance with Protocol 27 (d) of the EEA Agreement by means of a copy of the letter to the complainant.

Done at Brussels, 17 April 1996

For the EFTA Surveillance Authority


Knut Almestad
President


Björn Friðfinnsson
College Member

Annex

Technical note

Method applied for calculating the aid element related to the public loans awarded to Ryfylke Hotell Eigedom A/S

The aid element related to the interest rate rebates is estimated by comparing the difference in payments which arise from annuities carrying respectively the nominal interest rates indicated below and the relevant reference rate of interest.

The grant equivalent of the aid element equals the discounted value of the difference in payments referred to above plus the discounted present value of the interest rebate in the period exempted from repayment of principal.

Loan from Rogaland Fylkeskommune

Principal:	NOK 3,750,000
Nominal rate of interest:	7 % p.a.
Reference rate of interest:	7.5 % p.a. (1994)
Payments:	2 per year (equal instalments)
Handling fee:	NOK 100 per payment
Duration:	22 years
Exemption from repayment on principal:	2 years

Saving on payments per year:	NOK 6'734.
Present value saving on payments:	NOK 138'399
Present value of int. rate rebate in period exempted from repayment on principal:	NOK 15'281
Aid element (grant equivalent):	NOK 153'680

Loan from Ulla-Førre Næringsfond

Principal:	NOK 3,900,000
Nominal interest rate:	7 % p.a.
Reference rate of interest:	8.19 % p.a. (1995)
Payments:	1 per year (equal instalments)
Handling fee:	0
Duration:	23 years
Exemption from repayment on principal:	3 years

Saving on payments per year:	NOK 34'724
Present value saving on payments:	NOK 336'159
Present value of int. rate rebate in period exempted from repayment on principal:	NOK 48'485
Aid element (grant equivalent):	NOK 384'645

Method for estimating the aid element related to the public equity capital

The policy established for distinguishing between circumstances when the concept of State aid in the meaning of Article 61(1) EEA is applicable for the provision of public equity capital is embodied in the "rational market economy investor principle". This principle is elaborated in chapters 19 and 20 of the State Aid Guidelines.

In accordance with point 19.6.(c) of the State Aid Guidelines, the private shareholder's injection of NOK 2.3 million in share capital, which constitutes only a minority private ownership share of 18 % in the hotel project, would normally not have been considered sufficient to make it plausible that the municipality had purely commercial motives for its provision of equity capital.

The municipality authorities, in common with any other market economy investor, should have expected a normal return obtained by comparable private enterprises on their capital investments by way of dividend or capital appreciation. The rate of return is measured by the profit (after capital depreciation but before taxation and disposals) expressed as a percentage of the assets employed.

It is possible to estimate the value of RHE as a real estate company and on this basis, in accordance with point 20.7.1. of the State Aid Guidelines check whether the present value of the expected future dividend from the hotel project exceeds the outlay with respect to equity capital.

The present value of RHE's dividend is estimated to NOK 7.4 million. This amount is clearly lower than the equity capital of NOK 12.7 million. It may therefore be assumed that a reasonable return on the vested capital could not have been expected and that part of the equity capital provided by the municipality amounts to State aid. The grant equivalent of the aid is estimated to NOK 4.3 million which is equivalent to 16.7 % of the project costs. A more detailed account of the calculations and assumptions is presented below.

Project costs:	NOK 25.850 million
- Loan financing	NOK 13.150 million
<u>= Equity capital</u>	<u>NOK 12.700 million</u>
- Private equity participation	NOK 2.300 million
<u>= Public equity participation</u>	<u>NOK 10.400 million</u>
Present value (PV) of flow of (minimum) rent income	NOK 20.584 million
- Loan financing	NOK 13.150 million
<u>Present value of return on equity capital</u>	<u>NOK 7.434 million</u>
PV of public share (82 %) of return on equity capital	NOK 6.096 million
- Public equity participation	NOK 10.400 million
<u>= Aid related to public equity part.</u>	<u>(-) NOK 4.304 million</u>

Assumptions

The present value of the share capital equity is equal to the present value of the flow of income generated by the hotel project, i.e. minimum rent paid by RTH less loan financing. The sales value of the hotel used by SR Bank in their credit rating of the project has been chosen (among other alternatives) as the future value of the hotel for calculation purposes. RHE's income from the hotel project has been set equal to the minimum rent stipulated in the rental contract between RHE and RTH.

Duration of contract:	30 years
Rental payments:	quarterly
Rent:	12 % of turnover or
Minimum rent:	NOK 1.2 mill./year in year 1-3 NOK 1.6 mill./year in year 4-30
Future value :	NOK 10 mill. in 1996 prices
(= NOK 24.273 million (nominal 2026 price = 1996 price adjusted for 3 % inflation over 30 years)	
Discount rate:	7.5 % p.a. (reference rate of interest in 1994)

Present value of minimum rent + discounted future value of the hotel:
NOK 20.584 million